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Edmonton, Alberta T6G 2R6

PETRO-REEF RESOURCES LTD.

1998

ANNUAL REPORT

REPORT TO THE SHAREHOLDERS

During the 1998 fiscal year the Company drilled and completed three (3) wells all of which have production casing set and are waiting for production test and tie-in to existing production facilities. In addition, six (6) other wells previously drilled will be completed and tied in for production during the second and third quarters of 1999.

During the last quarter of 1998 and first quarter of 1999 the Company increased its land position from 2560 acres to 6665 acres in a core area of Central Alberta and increased its working interest position from an interest varying from 16.25% to 19.50% to an interest varying from 30.00% to 73.00% (an increase of 13.25% to 53.50%). As a complement to this increase of land position and increased working interest Petro-Reef has shot and purchased approximately thirty (30) miles of 2 -D and 3-D seismic.

On April 7, 1999 the Company issued the following press release

PETRO-REEF RESOURCES LTD.

DATE: APRIL 7, 1999
CONTACT: TED DONHUYSEN
TELEPHONE: (403) 265-6444

FOR IMMEDIATE RELEASE

PETRO- REEF RESOURCES LTD. announces that on April 6, 1999 it received an independent engineering report prepared by Status Engineering Associates Ltd. of Calgary, effective March 1, 1999.

The report indicates the present value of the discounted cash flow which may be realized from proven and probable reserves, assuming certain capital expenditures, net to the Corporation, to be as follows:

Present Value of Discounted Cash Flow

Escalated Prices and Costs (1)

Discount Factor	0%	10%	15%
Proven	$ 7,797,900	$ 3,333,200	$ 2,435,400
Risked Probable (2)	$34,162,400	$19,396,100	$15,412,400
Total: (3)	$41,960,300	$22,729,300	$17,847,800

Constant Prices and Costs

Discount Factor	0%	10%	15%
Proven	$ 5,933,300	$ 2,749,700	$ 2,048,500
Risked Probable (2)	$28,951,000	$16,970,800	$13,617,700
Total: (3)	$34,884,300	$19,720,500	$15,666,200

NOTES: (1) Based on oil prices of $17.23 (Canadian) and gas prices of $2.42 (Canadian) escalated at 3% per annum.

(2) Based on 1/2 of the estimated reserves and 100% allocation of costs.

(3) Based on approximately 60% oil and 40% natural gas.

The Corporation currently has only a minor amount of its reserves on production.

On the basis of the report, using the escalated 15% present value of discounted cash flow, the Corporation has calculated its approximate net asset value per share as follows:

basic	$1.45
fully-diluted	$1.33

The Corporation believes that these dramatic results are a product of the use of new technology and interpretive techniques which have been employed within the last year.

The Corporation is currently investigating possible financing arrangements to exploit its reserves.

The oil prices (in the escalated case) used in the engineering report are $17.23 (Cdn. $) per barrel and escalated at 3% per year. (Current prices are approximately $20.50 Cdn. per barrel). Gas prices (in the escalated case) used in the engineering report are $2.42/Mcf (Cdn. $) and escalated at 3% per year.

These values compare to a booked value for the Company of $941,561 as presented on the balance sheets as at December 31, 1997. It is important to note that this dramatic increase in asset value is as a direct result of a change in philosophy by the Company in exploration and development of hydrocarbons utilizing state of the art seismic shooting, processing and interpretative techniques using 3-D seismic.

The Company continues to concentrate its efforts in Central Alberta where multi-zone potential, for oil and gas, and existing infrastructure of plants and pipelines make early cash flow possible.

The core area of operations which initially started with the area north of Edmonton has been expanded to include much of Central Alberta. Several dozen high grade, multi-zone, prospects have been identified. The Company is currently pursuing some of these prospects through an aggressive property acquisition program.

Although the Company currently has only a minor amount of its reserves on production gross revenues increased for fiscal year 1998 to $259,578 versus $102,237 for 1997. Cash Flow increased for fiscal year 1998 to $86,818 versus a net deficiency of ($77,254) for 1997.

In February, 1999 the Company added a member to its board of directors for a total of six. The new board member is Mr. Bert Kloster whose experience includes several years in oil and gas finance with a major Canadian bank. In addition, until the latter part of 1998, Mr. Kloster was the chief financial officer of an intermediate oil and gas exploration and production company. The addition of Mr. Kloster adds the financing and financial expertise that was needed at the board level.

With respect to the future of natural gas prices, the building of the Alliance gas pipeline, will for the first time provide long term competitive pipeline capacity for gas production in the Western Canadian Sedimentary Basin. I believe this will accordingly assure that Canadian natural gas will receive the highest possible netbacks for producers.

On the crude oil side of the equation, I believe that the Asian economic crisis is being solved and that OPEC has finally learned its lesson on sticking with production cuts. Furthermore recent exploration contracts between major oil firms and several OPEC nations at higher than current prices all indicate that there will be a world-wide increase in the demand for crude oil and as a result prices will continue to move up to $18 (U.S) per barrel by the end of 1999 and will continue to escalate thereafter.

On behalf of the Company and its board of directors, I would like to thank the shareholders for their continued support. We will endeavour to meet and hopefully exceed your expectations with significant increases in cash flow per share and a higher share price for the Company for the fiscal year 1999 and continuing into the next millennium.

Dated April 8, 1999

Signed "T.M. Donhuysen"
President & C.E.O.

PRICEWATERHOUSECOOPERS

Petro-Reef Resources Ltd.

Financial Statements
December 31, 1998 and 1997

PRICEWATERHOUSECOOPERS

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Chartered Accountants
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Calgary Alberta
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February 26, 1999

Auditors' Report

To the Shareholders of
Petro-Reef Resources Ltd.

We have audited the balance sheets of **Petro-Reef Resources Ltd.** as at December 31, 1998 and 1997 and the statements of earnings and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the company as at December 31, 1998 and 1997 and the results of its operations and its cash flows for the years then ended in accordance with generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants

PricewaterhouseCoopers LLP is a Canadian member firm of PricewaterhouseCoopers International Limited, an English company limited by guarantee.

Petro-Reef Resources Ltd.

Balance Sheets

As at December 31, 1998 and 1997

	1998 $	1997 $
Assets		
Current assets		
Cash and short-term investments	185,289	171,402
Accounts receivable	153,075	80,039
Prepaid expenses and deposits	17,562	11,029
	355,926	262,470
Property, plant and equipment (note 2)	732,821	679,091
	1,088,747	941,561
Liabilities		
Current liabilities		
Accounts payable and accrued charges	245,796	187,215
Future site restoration	3,439	1,099
	249,235	188,314
Shareholders' Equity		
Share capital (note 3)	778,247	2,326,599
Retained earnings (deficit)	61,265	(1,573,352)
	839,512	753,247
	1,088,747	941,561

The accompanying notes are integral to the financial statements.

Approved by the Board of Directors

Director

Director

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Petro-Reef Resources Ltd.

Statements of Earnings and Retained Earnings

For the years ended December 31, 1998 and 1997

	1998 $	1997 $
Revenue		
Oil and gas sales, net of royalties and ARTC	151,919	54,720
Overhead recoveries	97,381	42,637
Interest income	10,278	4,880
	259,578	102,237
Expenses		
Production	63,775	25,568
General and administrative	108,985	153,923
Depletion, depreciation and amortization	25,553	27,648
	198,313	207,139
Net earnings (loss) for the year	61,265	(104,902)
Deficit – Beginning of year	(1,573,352)	(1,468,450)
Elimination of deficit (note 3)	1,573,352	–
Retained earnings (deficit) – End of year	61,265	(1,573,352)
Basic and fully diluted earnings (loss) per common share	0.01	(0.01)

The accompanying notes are integral to the financial statements.

Petro-Reef Resources Ltd.

Statements of Cash Flows

For the years ended December 31, 1998 and 1997

	1998 $	1997 $
Cash flows from operating activities		
Net income for the year	61,265	(104,902)
Items not affecting working capital		
Depletion, depreciation and amortization	25,553	27,648
	86,818	(77,254)
Net change in non-cash working capital items	(20,988)	115,597
	65,830	38,343
Cash flows from financing activity		
Issuance of common shares	25,000	165,000
Cash flows from investing activity		
Expenditures on property, plant and equipment	(76,943)	(95,614)
Change in cash and short-term investments during the year	13,887	107,729
Cash and short-term investments – Beginning of year	171,402	63,673
Cash and short-term investments – End of year	185,289	171,402
Basic and fully diluted cash flow (deficiency) per share	0.01	(0.01)

The accompanying notes are integral to the financial statements.

1 Accounting policies

Oil and gas operations

The company is engaged in the exploration for and production of oil and natural gas in Canada.

The company follows the full cost method of accounting for oil and gas operations whereby all costs related to the acquisition of, exploration for and development of oil and gas reserves are capitalized. Such costs include leasehold acquisition costs, geological and geophysical costs, lease rentals, drilling, plant and equipment costs and related overhead. Government incentives are credited to the cost of the oil and gas properties at the time the expenditures are incurred. Proceeds from the disposal of properties are applied as a reduction of the cost of the remaining assets with no gain or loss recognized, unless such a sale would result in a change of more than twenty percent in the depletion rate.

In applying the full cost method, the company calculates a cost ceiling which restricts the capitalized costs less accumulated depletion from exceeding the estimated future net revenue from proved reserves, determined by independent reservoir engineers, based on year-end prices and production costs plus the net cost of undeveloped acreage, less future general and administrative expenses, financing costs, site restoration costs and income taxes.

Depletion is computed using the unit-of-production method based on gross estimated proved oil and gas reserves (converted to equivalent units on the basis of estimated relative energy content). In determining the appropriate depletion rate, the company considers the net book value of its proved oil and gas properties, as well as the estimated future costs to be incurred in developing proved reserves and the cost of undeveloped acreage.

Estimated costs of future abandonment and restoration of well sites and associated facilities are amortized over the life of the properties on a unit-of-production basis.

Depreciation

Depreciation of furniture and fixtures is calculated using the declining balance method at an annual rate of 20%.

Income taxes

The company follows the tax allocation method of accounting for income taxes whereby the income tax provision for the year is based on the income reported in the accounts. Under this method, the company provides for deferred income taxes as a result of claiming deductions for income tax purposes in excess of amounts claimed for financial statement purposes.

Joint ventures

Substantially all of the company's activities are conducted jointly with other industry partners and accordingly, these financial statements reflect only the company's proportionate interest in such activities.

2 Property, plant and equipment

	1998		
	Cost $	Accumulated depletion and depreciation $	Net $
Petroleum and natural gas	2,022,701	1,294,882	727,819
Furniture and fixtures	13,538	8,536	5,002
	2,036,239	1,303,418	732,821

	1997		
	Cost $	Accumulated depletion and depreciation $	Net $
Petroleum and natural gas	1,945,758	1,272,920	672,838
Furniture and fixtures	13,538	7,285	6,253
	1,959,296	1,280,205	679,091

No interest or general and administrative expenses were capitalized during the year.

Unproven property costs of $67,037 (1997 - $107,022) have been excluded from capitalized costs subject to depletion.

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3 Share capital

The authorized share capital of the company is comprised of an unlimited number of preferred shares and an unlimited number of common shares. Details of the changes in the company's share capital during 1998 and 1997 are as follows:

	1998		1997	
	Number of shares	**Amount $**	**Number of shares**	**Amount $**
Common shares				
Balance – Beginning of period	12,171,494	2,326,599	11,571,494	2,171,599
Issued pursuant to stock options being exercised	100,000	25,000	600,000	155,000
Elimination of deficit	–	(1,573,352)	–	–
Balance – End of period	12,271,494	778,247	12,171,494	2,326,599

Pursuant to a special resolution passed at a special meeting of the shareholders of the Company on May 1, 1998, the company's stated capital was reduced by offsetting the deficit in the amount of $1,573,352 and the share capital amount by $1,573,352.

Earnings per common share are calculated using the weighted average number of common shares outstanding during the year of 12,251,494 (1997 - 12,111,494).

Stock options

The company has reserved 1,217,000 (1997 - 1,217,000) shares for issuance under stock option agreements with certain directors, officers and employees. The options expire after a maximum exercise period of three years from the date of issuance. The options outstanding at year-end were as follows:

	1998 $	**1997 $**
Balance – Beginning of year	1,217,000	900,000
Granted	100,000	917,000
Exercised	(100,000)	(600,000)
Balance – End of year	1,217,000	1,217,000

4 Income taxes

At December 31, 1998, the company has approximately $1,893,000 (1997 - $1,789,000) of tax pools available for deduction from future taxable income of which $427,007 (1997 - $427,007) are successor pools. In addition, the company has non-capital tax losses of approximately $270,000 (1997 - $349,000) the benefit of which has not been reflected in these financial statements due to a lack of virtual certainty of realizing the tax benefit.

These losses expire as follows:

Expiry date	Amount $
2002	139,567
2003	67,733
2004	62,721

The income tax provision differs from the amount computed by applying the expected income tax rate of 44.62% (1997 - 44.62%) to earnings before taxes. The reasons for this difference are as follows:

	1998 $	1997 $
Earnings (loss) before taxes	61,265	(104,902)
Effective tax rate	44.62%	44.62%
Expected tax expense (recovery) at combined federal and provincial rates	27,336	(46,807)
Crown royalties and production taxes	10,512	3,728
Alberta royalty tax credit	(7,290)	(2,287)
Crown lease rentals	(1,419)	(37,380)
Resource allowance	(7,632)	–
Other	5,515	2,388
Benefit of losses (recognized) not recognized	(27,022)	80,358
	–	–

5 Commitments

The present office lease agreement expires on August 31, 2003. Future lease payments over the next four years (1999 – 2002) under the company's office lease total will be $42,032 per year. The lease payments for 2003 will total $28,021.

6 Related party transactions

In 1998, companies controlled by directors of the company received $25,000 (1997 - $50,000) as remuneration for their services. Prior to 1997, these directors had not been remunerated for their services since December 15, 1992.

During the year, companies controlled by two directors also received $1,727 (1997 - $nil) of revenue relating to a gross overriding royalty agreement between the companies and Petro-Reef Resources Ltd.

7 Financial instruments

Financial instruments include cash and short-term investments, accounts receivable, and accounts payable and accrued charges. At December 31, 1998, the fair market value of the financial instruments approximated their carrying value due to the short-term maturity of these instruments.

8 Uncertainty due to the Year 2000 Issue

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date. The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the entity, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

9 Subsequent event

The company received an unsecured loan from a third party in the amount of $185,000 with no repayment terms and interest payable annually at 7%.

PETRO-REEF RESOURCES LTD.
CORPORATION INFORMATION

Directors and Officers

Theodore M. Donhuysen
Chief Executive Officer
President & Director
Calgary Alberta

Joseph Werner
Chairman of the Board
Chief Financial Officer & Director
Calgary Alberta

Robert N. Maertens-Poole
Director
Calgary Alberta

Douglas W. Schneider
Director
Calgary Alberta

John Lagadin
Director
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Nobert Kloster
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R. Greg Powers

Assistant Secretary
Gary W. Coleman

Bank
Hongkong Bank of Canada

Auditors
PricewaterhouseCoopers

Registrar & Transfer Agent
The CIBC Mellon Trust Company

Stock Listing
The Alberta Stock Exchange
Symbol "PER"